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IN THE

# Supreme Court of the United States

October Term, 1962

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No. 150

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HAROLD J. SILVER, d/b/a MUNICIPAL SECURITIES COMPANY and MUNICIPAL SECURITIES COMPANY, INC.,

*Petitioners,*

v.

NEW YORK STOCK EXCHANGE,

*Respondent.*

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## REPLY BRIEF FOR PETITIONERS

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## REPLY BRIEF FOR PETITIONERS

### Statement

The United States argues that the NYSE is authorized to require its members, who are engaged in legal and ethical dealings with nonmembers, to cease doing business with such nonmembers, provided that the Exchange makes a reasonable determination, after notice and hearing, that these nonmembers are untrustworthy or unreliable (Gov't Br., 43-52). The NYSE agrees, except it urges that the test should not be "reasonableness", but whether "the Exchange acted in good faith and within the scope of its statutory authority" (Res. Br., 28). Since a nonmember aggrieved by Exchange action purportedly taken under its filed rules has no administrative remedy before the SEC (R. 222; Gov't Br., 41), adopting these arguments would vest in the New York Stock Exchange power to determine the life or death of nonmember over-the-counter securities dealers, to the exclusion of the only agencies charged with

responsibility in such matters—the SEC and NASD (See Pet. Br., 22-27).

In our view, these attempts to "accommodate" the antitrust laws out of existence insofar as they apply to registered securities exchanges must fail. *Sinclair Refining Co.* v. *Atkinson*, 370 U. S. 195, 204-205, 209-210 (1962). When Congress intended to permit private associations, sharing responsibility with the SEC for policing a particular securities market, to promulgate rules in effect prohibiting members from dealing with, or providing services to, nonmembers, it did not hesitate to say so and, in fact, specifically granted such associations antitrust immunity. See sections 15-A(b) (9) and 15-A(n) of the Act, 15 U. S. C. §§ 78o-3(b)(9), 78o-3(n) and discussion of cooperative over-the-counter securities regulation by the NASD and SEC (Pet. Br., 25-27). The foregoing makes clear "how far Congress intended that the [Securities Exchange Act] should operate to render the Sherman Act inapplicable. If Congress had desired to grant any further immunity, Congress doubtless would have said so". *United States* v. *Borden Co.*, 308 U. S. 188, 201-202 (1939).

## I.

## The NYSE's Action Was Not Immunized From the Antitrust Laws.

### A. The Government's Brief.

The Government's basic error (Gov't Br. 43-52) is its failure to recognize that cooperative policing activities by the SEC and the Exchange under the 1934 Act are limited to Exchange *members* or *member firms*. Section 6(b) of the Securities Exchange Act, 15 U. S. C. § 78f(b), which requires the NYSE's rules to "include provision for the expulsion, suspension, or disciplining of a *member* for conduct or proceeding inconsistent with just and equitable

principles of trade * * * ", says nothing about the conduct of nonmembers. And, according to SEC Commissioner Healy, the "phrase 'just and equitable principles of trade' * * * was well and probably universally understood to govern the dealings of [stock exchange] members with each other." *National Association of Securities Dealers, Inc.*, 19 SEC 424, 484 (1945). Congress was well aware that "control exercised by stock exchange authorities is admittedly limited to their own members, and they are unable to cope with those practices of nonmembers which they deplore but cannot prevent." *S. Rep. No. 792 on S. 3420* 73d Cong. 2d Sess., 4 (1934).

The power to terminate a member's wire connection with unethical or unreliable broker-dealers, while "certainly conducive to the promotion of [*nonmember*] conduct consistent with just and equitable principles of trade", is unlikely to promote such conduct on the part of members. The Government's contrary assertion (Gov't Br. 45) is specious.[1] Therefore, since exchange officials disclaimed any "power to prevent abuses" by nonmembers (*S. Rep. No. 1455, pursuant to S. Res. No. 84,* 73d Cong. 2d Sess., 81 [1934]), and since that disclaimer was one of the reasons why Congress rejected the exchanges' view "that *internal* regulation obviated the need for governmental control * * * " (*S. Rep. No. 792 on S. 3420,* 73d Cong. 2d Sess., 4 [1934]), power to prevent nonmember abuses was vested not in the exchanges, but in the SEC under Sections 19(a)(3) and 21(e) of the Act. 15 U. S. C. §§ 78s(a)(3), 78u(e) (See

[1] While exchange members "have a perfect right as between themselves to ordain what should constitute the ethics of the trade or profession * * * , [the Exchange cannot] prevent the continuance of a proper and lawful business so long as the plaintiff conducts its business in a legal manner and without complaint from the buying and selling public, or from those officials elected to enforce either civil or criminal law who have power to stop any abuses or fraud." *Pirnie Simons & Co.* v. *Whitney*, 144 Misc. 812, 259 N. Y. S. 193, 211-212 (1932).

Pet. Br. 23). That Congress in the 1934 Act gave power to prevent nonmember abuses to the SEC *exclusively* is manifest not only from Sections 19(a)(3) and 21(e) of the Act, but from Section 15 of the Act (the broker-dealer registration provision) as well. Under this latter provision it is the SEC which is authorized to investigate the character, reputation and business ethics of nonmembers and to take action, after notice and hearing, in accordance with specific statutory criteria.[2]

The Government is therefore in error when it asserts that respondent's antitrust liability turns on the "reasonableness" of the Exchange's determination after notice and hearing (Gov't Br. 50-52). Immunity from the antitrust laws cannot be predicated upon the establishment of "an extra-governmental agency, which prescribes rules for the regulation and restraint of interstate commerce, and provides extra-judicial tribunals for determination and punishment of [nonmember] violations * * *." *Fashion Originator's Guild* v. *FTC*, 312 U. S. 457, 465 (1941). *A fortiori*, where Congress provides an administrative agency with the power to prevent nonmember abuses, the authority to investigate, and the authority to take action under specific statutory criteria in accordance with "due process", counterpart regulation by the Exchange is foreclosed, unless Congress specifically states otherwise. Cf. *Garner* v. *Teamsters, Chauffeurs and Helpers etc.*, 346 U. S. 485, 490-491 (1953).

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[2] These criteria are (1) willful material false statements in registration applications; (2) conviction of a felony or misdemeanor arising out of the conduct of the business of a broker or dealer within the ten years preceding registration; (3) injunction by court order restraining any practice connected with sale or purchase of any security; and (4) a willful violation of any provision of the Act or any SEC rule or regulation thereunder. 15 U. S. C. § 78o(b).

**B. Respondent's Brief.**

The order of the district court in no way affected the Exchange's right to regulate its members with respect to their manner of "soliciting business" or their "reporting of transactions on the exchange" and was restricted to private wire connections used for trading or otherwise dealing "in over-the-counter securities, municipal bonds or securities not listed for trading on the New York Stock Exchange" (R. 240). Respondent ignores that order and argues that since the private wires "were used by members for 'soliciting business' and were obtained by Municipal Inc. for the express purpose of, and in fact used for, obtaining quotations of 'transactions on the Exchange'" (Res. Br. 23), its wire connection rule[3] was subject to alteration or amendment by the SEC under sections 19(b) and 23(a) of the Securities Exchange Act, 15 U. S. C. §§ 78s(b), 78w(a) (Res. Br. 22-26).

Respondent's argument might have had more merit if the Exchange had directed its various member firms not to solicit "listed" business or report "transactions of listed securities" over their respective private wires with petitioners. The Exchange did not do this. Instead, on February 12, 1959, the NYSE informed those of its member firms listed on its records as having private wires with petitioners that:

> "Effective immediately, the Exchange has withdrawn the temporary approval granted your firm * * *. We would appreciate your advising us as soon as this wire has been discontinued." (R. 63)

Since MSC used its private wires with member firms solely to obtain quotations and transact business "in municipal securities, municipal bonds, and unlisted securities" (R. 155) and since MSC, INC. did no "listed" business over

[3] See Pet. Br. 17-18.

its private wires with some member firms (R. 80),[4] it is plain that the wire connection rule, as applied, was nothing more than a device through which respondent excluded petitioners from a substantial part of the over-the-counter securities market (Pet. Br. 17-20). The order of the district court (R. 240) was directed to that evil.

Accordingly, there is no "supersession to an extent" problem whatsoever. Section 19(b) of the Act, which gives the SEC power to "insure fair administration of [the] Exchange" with respect to exchange rules concerning "(8) the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange * * *; and (13) similar matters," 15 U. S. C. § 78s(b), does not include private wires between members and nonmembers used to communicate with respect to over-the-counter securities (Pet. Br. 28-29).[5] Assuming, *arguendo*, that it does,

[4] The widespread use of private wires to trade in over-the-counter securities is well known (see Pet. Br. 15-17) and this knowledge is shared by the NYSE and its member firms (R. 84). Furthermore, the NYSE asserted that it "undertook an investigation of [MSC, INC.] and its officers through independent agencies which defendant believed to be reliable and well-qualified" (R. 97) and that it took the action it did "only after careful consideration" of the "results of [that] investigation * * * " (R. 125). If, "after careful consideration" of the results of that investigation, the NYSE was unaware that MSC and MSC, INC. were using their private wires to trade and communicate with respect to transactions in over-the-counter securities and municipal bonds, it could have obtained that information simply by asking its member firms. In any event, since the necessary effect of the NYSE's action was to prohibit MSC and MSC, INC. from using its private wires with member firms to effect transactions in over-the-counter securities and municipal bonds, respondent "must be held to have intended the necessary and direct consequences of [its] acts, and cannot be heard to say the contrary." *United States* v. *Patten*, 226 U. S. 525, 543 (1913).

[5] As the district court pointed out, "the definition of an Exchange 'facility' in subsection 3a(2) of the 1934 Act * * * does not include private wire connections between members and nonmembers. A 'facility' is defined as including an exchange's ' * * * premises, tangible or intangible property whether on the premises or not, any right to

nothing in either the 1934 Act or its legislative history reveals that SEC was given power to decide antitrust issues as such (*United States* v. *RCA*, 358 U. S. 334, 346 [1959]), or that SEC inaction was intended to prevent enforcement of the antitrust laws in the courts. *United States* v. *Borden Co.*, 308 U. S. 188, 197-198 (1939). For, while antitrust considerations are indeed relevant to the performance of the SEC's functions under sections 19(b) and 23(a) of the Act (Res. Br. 26), "there is no 'pervasive regulatory scheme' including the antitrust laws that has been entrusted to the Commission." *California* v. *FPC*, 369 U. S. 482, 485 (1962). Moreover, whatever the scope of sections 19(b) and 23(a) of the Act with respect to the wire connection rule itself, "the Commission cannot review the application of the rules of an exchange in a particular case * * *" (Gov't Br. 41). "[T]he Commission lacks power to grant relief * * *" against the wire connection rule, as applied, and, hence, there is in this case no repugnancy between the Sherman and Securities Exchange Acts. *Georgia* v. *Pennsylvania R. Co.*, 324 U. S. 439, 461 (1945); *Pan American World Airways, Inc.* v. *United States*, 31 L. W. 4124, 4126 (1963).

The foregoing disposes of, not only the Exchange's arguments concerning "implied immunity" (Res. Br. 21-27), but

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the use of such premises or property *or any service thereof for the purpose of effecting or reporting a transaction on an exchange* (including, among other things, any system of communication *to or from the exchange* by ticker or otherwise maintained by or with the consent of the exchange) * * *'" (R. 222-223). The district court's conclusion is fortified by the meaning of the term "by or with the consent of the exchange" used in sections 3a(2) and 19(b)(8) of the Act. It refers to continuous stock (ticker service) quotations furnished by telegraph companies under contractual arrangements with exchanges. *Hunt* v. *New York Cotton Exchange*, 205 U. S. 322, 336 (1907); *Matter of Renville* (1st Dept.), 46 App. Div. 37, 38-43 (1899); *Tucker* v. *Western Union Telegraph Co.* (Sup. Ct., Erie Co.), 95 Misc. 287, 289-292 (1915). Such arrangements were a matter of congressional knowledge as early as 1913. *H. R. Rep. No. 1593*, 62d Cong., 3d Sess., 34 (1913).

also the Exchange's arguments concerning the *per se* rule (Res. Br. 33-35). Since petitioners were competing in the over-the-counter market with each of the Dallas member firms with whom they had private wire connections (R. 43-44, 128), it is irrelevant that the statute gives the Exchange disciplinary powers over exchange members "with respect to their transactions in over-the-counter securities and that the policy of the statute requires that the Exchange exercise these powers fully" (R. 266). It is as much a violation of the Sherman Act *per se* for competitors to foreclose another competitor from any substantial market, as it is for competitors to restrain independent action among themselves. *E.g., International Salt Co.* v. *United States*, 332 U. S. 392, 396 (1947); *Associated Press* v. *United States*, 326 U. S. 1, 13-14 (1945).

The fact that the Exchange is extensively regulated under the Securities Exchange Act and is obligated to enforce its rules, while relevant to the question of immunity, is therefore irrelevant to the question whether its conduct should be measured under a "rule of reason". Either the Exchange is exempted from the antitrust laws by statute or under the rule of "supersession to an extent"—or it is not exempted at all. Extensive regulation by administrative agencies does not diminish the vitality of the *per se* rule. *United States* v. *Socony Vacuum Oil Co.*, 310 U. S. 150, 225-228 (1940); *Pennsylvania Water Power Co.* v. *Consolidated G. E. L. & P. Co.*, 184 F. 2d 552, 557-560 (C. A. 4, 1950), certiorari denied, 340 U. S. 906 (1950); *Atchison, Topeka & Santa Fe Ry. Co.* v. *Aircoach Transport Association*, 253 F. 2d 877, 886-887 (C. A. D. C., 1958).

## II.

## Congress Provided No Immunity for Arbitrary Exchange Action.

The Exchange argues that it is acting in a governmental capacity comparable to that of the SEC (Res. Br. 18) and is immune from the antitrust laws, even for arbitrary action, so long as it acts "in good faith and within the scope of its statutory authority" (Res. Br. 28). We have already shown that exchange action directed not against illegal or unethical member conduct, but against nonmembers who maintain private wires with members, is not within the Exchange's authority, and the district court so held (R. 223-224).

While it is true that MSC, INC.'s "Application For Private Wire Connection" of June 13, 1958 (R. 47) did provide that the wire connection could be discontinued on the Exchange's withdrawal of approval (R. 49), it should be noted that MSC had three private wire connections with member firms for which no approval was sought (R. 42) and that the Exchange construed its action of February 12, 1959 to apply to such connections as well (R. 42-43, 93). Respondent argues, nevertheless, that since MSC, INC. expressly consented to the action complained of, it waived any rights it might have had to a hearing or to a disclosure of the reasons for the Exchange's action (Res. Br. 30-31).

In making this argument, respondent apparently believes that on June 13, 1958, it obtained an immunity from liability for antitrust violations occurring on February 12, 1959, and thereafter (R. 28-31). Respondent should know as well as anyone that an "instrument purporting to absolve a party from liability for future violations of the antitrust laws is void as against public policy." 6 *Toulmin's Anti-Trust Laws*, 588 (1951). There is no way (except, of course, statutory exemption) that respondent could have obtained "immunity from civil liability for future viola-

tions." *Lawlor v. National Screen Service Corp.*, 349 U. S. 322, 329 (1955). Respondent's "consent" argument would "permit a restraint of trade to be engaged in which would have impact, not simply between the parties, but upon the public as well." *Fox Midwest Theatres v. Means*, 221 F. 2d 173, 179-180 (C. A. 8, 1955).

If, as the Exchange asserts, it is immune from the antitrust laws by reason of the responsibilities delegated to it by Congress (Res. Br. 18-19), we must assume that Congress, which could not itself deny petitioners "due process," nonetheless permitted the NYSE to do so. This, of course, is absurd. Respondent cannot rely on its responsibilities under the Securities Exchange Act to justify arbitrary and unreasonable action. Cf. *International Association of Machinists v. Street*, 367 U. S. 740 (1961).

## CONCLUSION

**By reason of the foregoing, the decision below should be reversed.**

Respectfully submitted,

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